STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
VARRINGTON CORPORATION	:	DETERMINATION DTA NO. 810048
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 1984 through 1988.	:	

Petitioner, Varrington Corporation, 41 East 42nd Street, Suite 1610, New York, New York 10017, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1984 through 1988.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on June 29, 1993 at 1:15 P.M. Petitioner filed a brief and proposed findings of fact on August 30, 1993. The Division of Taxation filed a brief on November 2, 1993. Petitioner filed a reply brief on November 30, 1993. Petitioner appeared by Michelle Rice, Esq. The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly determined that petitioner, a foreign corporation, was doing business in New York during the years at issue and was therefore subject to corporation franchise tax pursuant to Tax Law § 209(1).

FINDINGS OF FACT

Petitioner, Varrington Corporation, was incorporated in the Netherlands Antilles in March 1983. During the years 1984, 1985 and 1986, petitioner was a Netherlands Antilles corporation. On December 31, 1986, petitioner became a Delaware corporation.

Petitioner is owned by two corporations, Beachwood, Ltd. and Mapledale, Ltd. Beachwood and Mapledale shared a Cayman Islands mailing address and each owned 50% of

the voting stock of petitioner. Frank Tsao, Peter Tan and J. P. Tsao were the directors and officers of petitioner during the years 1984 through 1988. None of the officers or directors of petitioner were present in New York during the years involved in this matter.

Shipcentral Realty, Inc. ("Shipcentral") is one of a group of companies (the "Shipcentral Group") owned by Franklin Tsao and his wife, Jean Rose Tsao. During the years 1984 through 1988, Franklin Tsao, Jean Rose Tsao, Marco Wong, Helena DiSenna and Andrew Russnok were the officers of Shipcentral. For the same years, Franklin Tsao, Jean Rose Tsao, Paul Caramella and Andrew Russnok were the directors of Shipcentral.

For the relevant taxable years, petitioner did not own any shares of Shipcentral or the Shipcentral Group. In addition, for the same period, Frank Tsao was not an officer or director of Shipcentral.

For the relevant taxable years, Franklin Tsao and Jean Rose Tsao were not shareholders of Beachwood Ltd. or Mapledale Ltd., nor was Franklin Tsao an officer or director of petitioner.

Frank Tsao and Franklin Tsao are brothers.

For the relevant period, petitioner did not have (a) employees in New York; (b) an office in the building at 41 East 42nd Street or otherwise in New York; (c) a listing in the directory of said building; or (d) a telephone or telephone listing in New York. For the same period, petitioner also did not own or lease property in New York. Nor did petitioner maintain any inventory or employ any assets in New York for this period. During this period, the only mail received by petitioner at 41 East 42nd Street was tax notices and unsolicited advertisements.

For the tax years in issue, petitioner appointed an agent in New York, Andrew Russnok, to sign its tax returns.

Richfield Investment Company (the "limited partnership" or "Richfield") owned the building at 41 East 42nd Street, New York, New York (the "Building") from 1984 through 1988. During those years, petitioner was a limited partner in Richfield. During the years 1984 through 1988, Shipcentral was a general partner in Richfield.

Petitioner was not involved in identifying or selecting the property that was ultimately

acquired by Richfield. Petitioner also was not involved in the negotiations concerning the financing of the acquisition of the Building.

For the relevant period, Shipcentral, as general partner, was responsible for the day-to-day operations of the Building. To that end, it was responsible for (a) overseeing the management company hired to manage the Building; (b) leasing space in the Building; and (c) securing insurance for the Building. In addition, Shipcentral had responsibility for reviewing and signing the limited partnership's tax returns and for reviewing and maintaining Richfield's accounting books and records.

Petitioner was not involved in any of the day-to-day operations or activities of Richfield during the relevant taxable years. Petitioner was not involved in (a) overseeing the management of the Building; (b) leasing the premises; (c) securing or maintaining insurance for the Building; (d) reviewing or signing the tax returns filed by Richfield; or (e) reviewing or maintaining the accounting books and records of the limited partnership. During the years at issue, petitioner's involvement in the limited partnership was strictly limited to its monetary investment. Additionally, petitioner's involvement in the limited partnership was its sole business activity.

Richfield was formed in June 1983. Petitioner, as limited partner, and Shipcentral, as general partner, formed the limited partnership. Petitioner contributed $16,200,000.00 to the limited partnership.

Petitioner does not challenge the Division of Taxation's ("Division") assertion that it contributed more than 50% of the limited partnership's capital for the period in issue. The 1987 and 1988 Federal partnership returns of Richfield indicate that petitioner owned 97.5% of the capital of the limited partnership and that Shipcentral owned 2.5% of the capital. These same returns indicate that petitioner's share of profits was 97.5% and its share of losses was 5%. The returns further indicate that Shipcentral's share of profits was 2.5% and its share of losses was 95%.

The partnership agreement was not entered into evidence.

The evidence presented at hearing by petitioner consisted of the testimony of Andrew

Russnok. Mr. Russnok is and was during the period at issue an officer and director of the corporations which comprise the Shipcentral Group. Mr. Russnok also is and was an employee of Shipcentral Limited, a member of the Shipcentral Group. During the period at issue, Mr. Russnok was responsible for all day-to-day operations of Richfield.

With respect to the negotiations of the limited partnership agreement, Mr. Russnok testified that, to the best of his knowledge, he was not aware of petitioner's participation in such negotiations. Mr. Russnok did not testify that he participated in the partnership agreement negotiations.

Petitioner timely filed franchise tax returns for 1984 through 1987. Petitioner did not file a franchise tax return for 1988.

In August 1988, petitioner filed amended franchise tax returns for the years 1984 through 1986, which included petitioner's statement of its position that it was not subject to the franchise tax.

On September 14, 1990, the Division issued to petitioner ten notices of deficiency which asserted additional corporation franchise tax and metropolitan transportation business tax surcharge, plus interest, as follows:

Tax Period	Tax Deficiency	Interest	Total
1984	$ 52,302.84	$ 0.00	$ 52,302.84
1984	8,955.00	0.00	8,955.00
1985	48,031.07	0.00	48,031.07
1985	8,222.07	0.00	8,222.07
1986	72,253.78	18,651.13	90,904.91
1986	12,333.98	3,218.19	15,552.17
1986	10.00	3.87	13.87
1987	47,736.72	5,174.99	52,911.71
1987	8,161.15	898.55	9,059.70
1988	36,285.76	6,391.49	42,677.25
1988	6,202.58	1,092.54	7,295.12
	$300,494.95	$35,430.76	$335,925.71

With its brief, petitioner submitted proposed findings of fact numbered "1" through "13". With minor changes, said proposed findings of fact are accepted and have been incorporated herein.

CONCLUSIONS OF LAW

A. Tax Law § 209(1) imposes an annual franchise tax upon every domestic or foreign corporation for the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property or of maintaining an office in the State of New York.

Tax Law § 209-B imposes a metropolitan transportation business tax surcharge upon every domestic or foreign corporation for the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property or of maintaining an office in the metropolitan commuter transportation district.

B. Regulations promulgated pursuant to Tax Law § 209(1), with respect to a foreign corporation which is a limited partner in a partnership which is doing business, employing capital, owning or leasing property or maintaining an office in New York, became effective June 25, 1990. Said regulations, at 20 NYCRR 1-3.2(a)(6) provide, in pertinent part, as follows:

> "(i) A foreign corporation is doing business, employing capital, owning or leasing property or maintaining an office in New York State if it is a limited partner of a partnership, other than a portfolio investment partnership, which is doing business, employing capital, owning or leasing property or maintaining an office in New York State and if it is engaged, directly or indirectly, in the participation in or the domination or control of all or any portion of the business activities or affairs of the partnership. A foreign corporation is engaged in such manner in the business activities or affairs of the partnership if one or more of certain factual situations, including but not limited to the following, exist during the taxable year or, except for clause (a) of this subparagraph, any previous taxable year:
>
> > "(a) The foreign corporation has a one percent or more interest as a limited partner in a partnership and/or the basis of the foreign corporation's interest in the limited partnership, determined pursuant to section 705 of the Internal Revenue Code, is more than $1,000,000.00. For purposes of determining whether the level of interest in the partnership or level of basis of the interest in the partnership is met, the percentage of interest in the partnership and basis of interest in the partnership of members of the foreign corporation's affiliated group, of officers or directors of the foreign corporation or of officers or directors of members of the foreign corporation's affiliated group are added to the foreign corporation's interest in the partnership or the basis of its interest in the partnership, respectively.
> >
> > "(b) An officer, employee, or director of the foreign corporation or an officer, employee, or director of a member of an affiliated group which includes such foreign corporation or a member of such an affiliated group, is

a general partner of the partnership.

"(c) The foreign corporation or a member of an affiliated group which includes the foreign corporation is a five percent or more stockholder in a general partner of the partnership.

"(d) One or more officers, employees, directors or agents of the foreign corporation, or of a member of an affiliated group which includes such foreign corporation, perform acts usually performed by a general partner.

"(e) The foreign corporation becomes a limited partner after one or more officers, employees, directors or agents of such corporation, or of a member of an affiliated group which includes such foreign corporation, negotiates the terms of the partnership agreement instead of merely accepting an existing agreement.

"(f) There is substantial communication between one or more officers, employees, directors or agents of the foreign corporation, or of a member of an affiliated group which includes such foreign corporation, and the general partner regarding the business activities or affairs of the partnership.

"(g) The foreign corporation, a member of an affiliated group which includes such foreign corporation, or an officer, employee, or director of the foreign corporation or of a member of such an affiliated group, guarantees payment of one or more loans to the partnership.

"(h) The foreign corporation, a member of an affiliated group which includes such foreign corporation, or an officer, employee, or director of the foreign corporation or of a member of such an affiliated group, makes loans to the partnership.

"(i) The foreign corporation is a limited partner which for purposes of section 469 of the Internal Revenue Code is materially participating in the partnership as defined in section 1.469-5T(e)(2) of the Federal income tax regulations (26 CFR 1.469-5T(e)(2)). For purposes of this clause, references to 'taxpayer' in such section 469 shall be deemed to mean any person, as defined in section 7701(a)(1) of the Internal Revenue Code.

"(j) The foreign corporation entered into the limited partnership arrangement not for a valid business or economic purpose, but for the principal purpose of avoiding or evading the payment of tax.

"(ii) Other factual situations, during the taxable year or any previous taxable year, to be considered as indications that a foreign corporation is engaged, directly or indirectly, in the participation in or the domination or control of all or any portion of the business activities or affairs of the partnership, include the following:

"(a) The foreign corporation, or a member of an affiliated group which includes such foreign corporation, sells its products and/or services to the partnership.

"(b) The foreign corporation, or a member of an affiliated group which includes such foreign corporation, purchases the partnership's products and/or services.

"(c) The foreign corporation, or a member of an affiliated group which includes such foreign corporation, is engaged in a similar or identical business to that of the partnership.

"(d) 50 percent or more of the foreign corporation's assets or those of a member of an affiliated group which includes such foreign corporation are a limited partnership interest in the partnership.

"(e) The business carried on by the partnership is integrally related to the business of the foreign corporation or a member of an affiliated group which includes such foreign corporation.

"(f) The foreign corporation exercises its voting rights as a limited partner to remove a general partner, to approve the sale of the partnership assets, to amend the partnership agreement or to dissolve the partnership.

"(g) The foreign corporation, or a member of an affiliated group which includes such foreign corporation, is interrelated with the partnership through one or more of the following factors:

"(1) common management;

"(2) common policy and directives including policy and directives relating to legal services, assignment or transfer of executive personnel, determination and enforcement of procedures to ensure compliance with the law, salary guidelines or uniform pay scale and/or labor relations activities;

"(3) common or inter-entity use of intelligent assets, such as patents, trademarks or copyrights;

"(4) common or inter-entity use of product distribution systems and/or warehousing functions;

"(5) common or inter-entity use of facilities, equipment, or employees;

"(6) common or inter-entity personnel recruitment;

"(7) common or inter-entity research and development activities;

"(8) common or inter-entity marketing and/or advertising;

"(9) common or inter-entity information processing and computer support, printing, telecommunications, and/or other support services;

"(10) common or inter-entity transfer or pooling of technical information;

"(11) common or inter-entity pension plans and/or insurance plans; or

"(12) common or inter-entity credit analysis and coordination of credit extension."

C. Although the regulations cited above were not effective until 1990 and the tax years at

issue are 1984 through 1988, such regulations are nonetheless applicable in the instant matter.

> "Although a taxing body does not have unfettered authority to make regulations retroactive (Central Illinois Public Service Co. v. United States, 435 U.S. 21, 33, 98 S.Ct. 917, 923, 55 L.Ed.2d 82 [Brennan, J., concurring]), and may not give retroactive effect to regulations that change settled law, particularly where it leads to harsh results for the taxpayer (Redhouse v. Commissioner of Internal Revenue, 728 F.2d 1249, 1251, 1252, cert. denied, 469 U.S. 1034, 105 S.Ct. 506, 83 L.Ed.2d 397), nevertheless, a taxing authority's retroactive application of a regulation will be upheld where the choice is a rational one supported by relevant considerations (Chock Full O'Nuts Corp. v. United States, 453 F.2d 300, 302)." (Matter of Varrington Corp. v. City of New York Dept. of Finance, ___ AD2d ___, 607 NYS2d 630.)

Here, retroactive application of the relevant regulations is appropriate because, first, regulations interpreting tax statutes are generally retroactive to the effective date of the statute to which they relate unless the taxing authority limits such retroactive application (see, Internal Revenue Code § 7805[b]; Matter of Varrington Corp. v. City of New York Dept. of Finance, supra). Second, the statute imposing the corporation franchise tax (Tax Law § 209[1]) was amended in 1969 to expand the bases by which tax under Article 9-A may be imposed on a foreign corporation. Prior to such amendment to Tax Law § 209(1), foreign corporations were subject to the franchise tax only if they were doing business in New York. The 1969 amendment to Tax Law § 209(1) added the other bases listed in Conclusion of Law "A" for imposing the franchise tax on foreign corporations. Accordingly, the broad statutory criteria for imposing franchise tax on foreign corporations had been in place since 1969 (see, Matter of Hugo Bosca Company, Inc. Tax Appeals Tribunal, October 17, 1991).

Further, contrary to petitioner's contention, prior to the effective date of the regulations, the law was not "clearly established" that a passive investment in a limited partnership would preclude taxation under Article 9-A (see, People ex rel Badishe Anilin & Soda Fabrik v. Roberts, 152 NY 59 [1897]; Matter of Chapman v. Browne, 268 App Div 806, 48 NYS2d 598). Additionally, in a 1954 opinion, the Attorney General concluded that a foreign corporation is doing business in New York by virtue of its status as a limited partner in a New York partnership (see, 1954 Opns Atty Gen 221). Thus, while three 1988 advisory opinions issued by the Division's Technical Services Bureau criticized the underlying rationale of the 1954

Attorney General opinion and Matter of Chapman v. Browne (supra) and offered a distinctly narrower view of the circumstances under which a foreign corporation could be found subject to franchise tax (see, TSB-A-88[5]C [March 10, 1988], TSB-A-88[10]C [April 19, 1988], TSB-A-88[11]C [April 19, 1988]), such opinions are binding only with respect to the person to whom the opinion is rendered (Tax Law § 171[24]). Moreover, the advisory opinions do not propose an unqualified position that nexus through limited partnership investment cannot result in taxation under Article 9-A. Rather, these opinions state that a "passive disinterested investment by the limited partnership" is the "key to nontaxability." This rationale is consistent with the regulations subsequently enacted in 1990. Thus, contrary to petitioner's assertion, prior to the enactment of the regulations, the law was not "well established" in favor of the nontaxability of foreign corporations having a passive limited partnership interest in a New York partnership. Furthermore, petitioner had filed its tax returns for the tax years 1984 through 1986 prior to the issuance of the advisory opinions in 1988. Petitioner may not, therefore, reasonably argue that it relied to its detriment on an established Division policy of not taxing foreign corporation limited partners (see, Matter of Varrington Corp. v. City of New York Dept. of Finance, supra).

That petitioner did not so rely to its detriment is evidenced by petitioner's timely filing of corporation franchise tax reports for the tax years 1984 through 1987. Petitioner would thus appear to have understood that it was subject to New York corporation franchise tax prior to its filing of amended returns in September 1988.

D. Applying the relevant regulations to the facts herein clearly requires a finding against petitioner on several grounds. First, petitioner owned $16,200,000.00 of the partnership capital during each of the tax years at issue. This amount is well in excess of the $1,000,000.00 level of interest which the regulation deems sufficient to constitute "doing business" in New York (see, 20 NYCRR 1-3.2[a][6][i][a]).

E. Petitioner contends that clause (a) of section 1-3.2(a)(6)(i) is not applicable herein by reason of the last sentence of subparagraph (i) of said section which states:

> "A foreign corporation is engaged in such manner in the business activities or affairs of the partnership if one or more certain factual situations, including but not

> limited to the following, exist during the taxable year or, except for clause (a) of this subparagraph, any previous taxable years."

Petitioner contends that this language indicates that clause (a) is applicable only on a prospective basis from the effective date of the regulations and therefore cannot be applied to the years at issue herein. This contention is rejected. As discussed previously, the relevant regulations herein may be retroactively applied. Further, the language cited by petitioner does not relate to the effective date of the regulation. Rather, such language merely states that a corporation is deemed doing business in New York during a given taxable year where it has an interest exceeding $1,000,000.00 during that year. The regulation further provides that a corporation is deemed doing business in New York during a given taxable year if certain other factual situations exist during that year or during any previous year. Thus, in order to trigger taxability, the $1,000,000.00 interest level must be present during the year at issue. In contrast, if certain other factors existed during any previous year, the corporation is deemed doing business in a later year.

F. Even if, as petitioner contends, clause (a) of section 1-3.2(a)(6)(i) were not applicable herein, petitioner is also properly deemed doing business in New York pursuant to clause (e). The record herein contains no evidence of petitioner's involvement in the negotiations of the Richfield partnership agreement. The only evidence on this point was Mr. Russnok's testimony that he was not aware of petitioner's involvement in the negotiations of the partnership agreement. Since the record contains no evidence that Mr. Russnok himself was involved in such negotiations, this testimony lends little support to petitioner's contention that it did not participate in such negotiations. The record does indicate that petitioner was an original partner in Richfield; that one of petitioner's principals, Frank Tsao, and Shipcentral's principal, Franklin Tsao, were brothers; and that petitioner invested $16,200,000.00 in the partnership. The record does not contain the partnership agreement. Given these facts, an inference that petitioner did negotiate the terms of the partnership seems reasonable.

G. Petitioner is also properly deemed doing business in New York pursuant to 20 NYCRR 1-3.2(a)(6)(ii). That provision lists factual situations "to be considered indications

that a foreign corporation is engaged, directly or indirectly, in the participation in or the domination or control of all or any portion of the business activities or affairs of the partnership." Two of the factual situations so listed are relevant herein. Subparagraph (d) of section 1-3.2(a)(6)(ii) states an indicia of participation, control or domination by the foreign corporation exists where 50% or more of the foreign corporation's assets are its limited partnership assets. Here, all or virtually all of petitioner's assets consisted of its interest in Richfield (see, Finding of Fact "12"). Subparagraph (e) of the same regulations states that an indicia of domination or control exists where the partnership business is integrally related to the foreign corporation's business. Here, Richfield's sole business is ownership of real property and petitioner's sole business is its investment in Richfield. Clearly, these businesses are integrally related.

Accordingly, given these factors which, pursuant to the regulation, indicate participation in or domination or control of the partnership, and given petitioner's domination in the ownership of capital of the partnership, it is concluded that petitioner was engaged, within the meaning of 20 NYCRR 1-3.2(a)(6)(ii), in the participation in or domination or control of the affairs of Richfield and was therefore properly deemed to be doing business in New York during the tax years at issue.

H. The Division also asserted that petitioner was subject to the franchise tax pursuant to subparagraphs (f) and (j) of 20 NYCRR 1-3.2(a)(6)(i). These arguments are rejected.

Subparagraph (f) of the subject regulation deems a foreign corporation to be doing business in New York where there is "substantial communication" between the foreign corporation and the general partner. The regulation does not define "substantial communication"; nor does the Division attempt to define this phrase. The Division contends that petitioner failed to meet its burden on this point. Given petitioner's involvement or lack thereof in the day-to-day affairs of the limited partnership as set forth in the facts herein, it is concluded that petitioner has shown that no "substantial communication" occurred between it and Shipcentral.

Subparagraph (j) provides that a foreign corporation is deemed to be doing business in New York where the foreign corporation entered into the limited partnership not for a valid business purpose but for the principal purpose of avoiding tax. The record herein clearly reveals a legitimate business purpose to petitioner's limited partnership arrangement, i.e., real estate investment. The Division's speculative assertion to the contrary is therefore rejected.

I. The Division also contended that petitioner is subject to franchise tax pursuant to 20 NYCRR 1-3.2(b)(2).[1] The Division argued that this

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[1]20 NYCRR 1-3.2(b)(2), as amended effective February 10, 1993, provides:

"(2) Whether a corporation is doing business in New York State is determined by the facts in each case. Consideration is given to such factors as:

"(i) the nature, continuity, frequency, and regularity of the activities of the corporation in New York State;

"(ii) the purposes for which the corporation was organized;

"(iii) the location of its offices and other places of business;

"(iv) the employment in New York State of agents, officers and employees; and

"(v) the location of the actual seat of management or control of the corporation."

20 NYCRR 1-3.2 former (b)(2) provided:

"(2) Whether a corporation is doing business in New York State is determined by the facts in each case. Consideration is given to such factors as:

"(i) the nature, continuity, frequency, and regularity of the activities of the corporation in New York State, compared with the nature, continuity, frequency, and regularity of its activities elsewhere;

"(ii) the purposes for which the corporation was organized, compared with its activities in New York State;

"(iii) the location of its offices and other places of business;

"(iv) the income of the corporation and the portion thereof derived from

regulation requires a comparison between a taxpayer's activities in New York and elsewhere. The Division contended that such a comparison in this case requires a finding that petitioner was doing business in New York.

The Division's contention is rejected. A review of section 1-3.2 of the regulations indicates that subdivision (a), paragraph (6) of said section defines the taxability of foreign corporations whose sole contact with New York is through a limited partnership interest in a New York partnership. Paragraph (2) of subdivision (b) of said section relates to corporations having direct contact with New York. Accordingly, this paragraph does not apply to a corporation in petitioner's circumstances.

It is further noted that section 1-3.2(b)(2) has been amended such that it no longer contains language requiring a comparison between a corporation's New York activities and activities elsewhere. The Division's argument that petitioner's New York activities relative to its activities elsewhere indicate that petitioner is subject to franchise tax is thus no longer valid.

J. The petition of Varrington Corporation is denied and the notices of deficiency, dated September 14, 1990, are sustained.

DATED: Troy, New York
May 26, 1994

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE

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activities in New York State;

"(v) the employment in New York State of agents, officers, and employees; and

"(vi) the location of the actual seat of management or control of the corporation." (Emphasis supplied.)